line. In that case, Employee R would be disregarded in applying paragraph (b)(4) of this section to the construction machinery and agricultural equipment lines of business.

Example 6. The facts are the same as in *Example 5.* Employee S is a lawyer in the legal department located at the headquarters who devotes all her time to product liability suits filed against the construction machinery line of business. Under these facts, the services of Employee S contribute to providing property and services to customers of Employer A in the construction machinery line of business, and therefore Employee S provides services to that line of business. Because Employee S's services do not contribute to providing property or services in any other of Employer A's lines of business within the meaning of paragraph (c)(5) of this section, Employee S provides more than 75 percent of her services to the construction machinery line of business and therefore is a substantial-service employee with respect to Employer A's construction machinery line of business within the meaning of §1.414(r)–11(b)(2).

Example 7. The facts are the same as in *Example 6.* Employer A also maintains a separate facility that houses a centralized procurement, marketing, and billing operation for all of its lines of business. None of the procurement, marketing, or billing employees specializes in any particular line of business. Under these facts, the services of the procurement, marketing, and billing employees contribute to providing property and services to customers of Employer A in each of Employer A's three lines of business. Employer A determines that each of the procurement, marketing, and billing employees provides approximately an equal proportion of their services to each of Employer A's three lines of business. These employees therefore provide services to all of Employer A's lines of business within the meaning of paragraph (c)(5) of this section. However, none of them provides at least 75 percent of his services to any line of business. Therefore, these employees are not substantial-service employees with respect to any of Employer A's three lines of business within the meaning of §1.414(r)–11(b)(2).

Example 8. The facts are the same as in *Example 7.* Employee T works for the construction machinery line of business. During the testing year, he is temporarily detailed to the agricultural equipment line of business. His temporary detail lasts for one week, after which he returns to his regular duties with the construction machinery line of business. Under these facts, Employee T does not provide more than a negligible portion of his services during the testing year to the agricultural equipment line of business. Accordingly, Employee T does not provide services to the agricultural equipment line of business within the meaning of paragraph (c)(5) of this section. In addition, because Employee T provides at least 75 percent of his services to the construction machinery line of business, Employee T is a substantial-service employee with respect to Employer A's agricultural equipment line of business within the meaning of §1.414(r)–11(b)(2).

Example 9. The facts are the same as in *Example 8,* except that, during the testing year but before the first testing day, Employee T retires from employment with Employer A. Under paragraph (c)(5)(ii) of this section, Employee T is not taken into account in determining whether Employer A's construction machinery line of business has its own separate employee workforce within the meaning of paragraph (b)(4) of this section.

Example 10. Employer B is a multinational controlled group of corporations that engages in the exploration, production, refining, and marketing of petrochemical products. Employer B operates two lines of business as determined under §1.414(r)–2. The first line of business (the ''exploration, production, and refining line of business'') provides lubricating oil, gasoline, and other petrochemical products to wholesale customers of Employer B as well as to the second line of business. The wholesale customers of Employer B include independent jobbers, independent franchisees that operate retail filling stations under Employer B's trademark and tradename, as well as chemical and plastics manufacturers. The second line of business (the ''retail marketing line of business'') provides lubricating oil and gasoline products to retail customers of Employer B through filling stations owned and operated by Employer B. Employee U is an attendant at a filling station owned and operated by Employer B. Employee U performs no other services for Employer B, Under these facts, Employee U provides at least 75 percent of his services to Employer B's retail marketing line of business and therefore is a substantial-service employee with respect to that line of business within the meaning of §1.414(r)–11(b)(2), and does not provide any services within the meaning of paragraph (c)(5) of this section to any of Employer B's other lines of business.

Example 11. The facts are the same as in *Example 10.* Employer B operates a refinery that produces lubricating oil, gasoline, and other petrochemical products. Employee V is an operating engineer at the refinery who is involved at a stage in the refining process before lubricating oil and gasoline products have been separated from other types of petrochemical products. Employee V performs no other services for Employer B. Under these facts, Employee V's services contribute to providing property and services to customers of Employer B in both the exploration, production, and refining line of business and the retail marketing line of business. Employee V therefore provides services

to both lines of business within the meaning of paragraph (c)(5) of this section. See paragraph (d) of this section, however, for an optional rule for vertically integrated lines of business.

Example 12. The facts are the same as in *Example 11.* Employee W is a petroleum engineer who conducts geological studies of potential future drilling sites. Although Employee W's services during the testing year will not contribute to providing lubricating oil, gasoline, and other petrochemical products to customers of Employer B during the testing year, it is reasonably anticipated (in accordance with paragraph (c)(5)(ii)(B) of this section) that her services during the testing year will contribute to providing such products to customers of Employer B after the close of the testing year. Under these facts, Employee W provides her services to both of Employer B's lines of business within the meaning of paragraph (c)(5) of this section.

(7) *Examples of the separate management requirement.* The following examples illustrate the application of the separate management requirement in paragraph (b)(5) of this section and the supplementary rules of this paragraph (c). Unless otherwise specified, it is assumed that employees who provide services to a line of business are not substantial-service employees with respect to any other line of business and that, in determining the top-paid employees with respect to a line of business, the employer is using the option under §1.414(r)–11(b)(3) to disregard all employees who provide less than 25 percent of their services to that line of business.

Example 1. (a) Employer C operates three lines of business as determined under §1.414(r)–2. One of its lines of business is the operation of a chain of athletic equipment and apparel stores. Of Employer C's total workforce, 12,000 employees provide more than a negligible amount of the services they provide to Employer C to the athletic equipment and apparel stores line of business, within the meaning of paragraph (c)(5) of this section. Of the 1,200 employees who constitute the top ten percent by compensation of those 12,000 employees, 930 are substantial-service employees with respect to that line of business. Because 930 is 77.5 percent of 1,200, less than 80 percent of the top-paid employees with respect to the line of business are substantial-service employees with respect to that line of business. Therefore, Employer C's athletic equipment and apparel stores line of business does not have its own separate management under paragraph (b)(5) of this section.

(b) Assume that, in determining the top-paid employees with respect to the athletic equipment and apparel stores line of business, Employer C chooses to disregard all employees who provide less than 25 percent of their services to the line of business as permitted under the definition in §1.414(r)–11(b)(3). Of the 12,000 employees who provide more than a negligible amount of their services to the athletic equipment and apparel stores line of business, 10,000 provide at least 25 percent of their services to that line. Of the 1,000 employees who constitute the top ten percent by compensation of those 10,000 employees, 930 are substantial-service employees with respect to the athletic equipment and apparel stores line of business. Because 930 is 93 percent of 1,000, at least 80 percent of the top-paid employees with respect to the line of business are substantial-service employees with respect to that line of business. Therefore, Employer C's athletic equipment and apparel stores line of business has its own separate management and satisfies the requirement of paragraph (b)(5) of this section.

Example 2. The facts are the same as in *Example 1.* Employee X is a vice president of the accounting department located at the headquarters, who devotes all of his time supervising the staff of Employer C's accounting department. Employer C determines that 10 percent of Employee X's services contribute to providing property and services to customers of Employer C's athletic equipment and apparel stores line of business and 45 percent of Employee X's services contribute to providing property and services to customers to each of Employer C's other two lines of business. Because Employee X does not provide at least 25 percent of his services to Employer C's athletic equipment and apparel stores line of business, Employee X is not one of the 10,000 employees described in *Example 1* and therefore cannot be a top-paid employee within the meaning of §1.414(r)–11(b)(3) with respect to the athletic equipment and apparel stores line of business. Therefore, Employee X is not taken into account in determining whether the athletic equipment and apparel stores line of business satisfies the separate management requirement of paragraph (b)(5) of this section.

Example 3. The facts are the same as in *Example 2* except that Employee X provides 60 percent of his services to Employer C's second line of business, an athletic equipment factory, and 30 percent of his service to Employer C's third line of business, a fast-food chain. Because Employee X provides at least 50 percent of his services to the athletic equipment factory line of business, Employer C chooses to treat him as a substantial- service employee with respect to that line of business, as permitted under

§1.414(r)–11(b)(2). Thus, Employee X is taken into account as a substantial-service employee with respect to the athletic equipment factory line of business and is disregarded in applying the separate workforce and separate management requirements under paragraphs (b) (4) and (5) to the fast-food chain line of business.

Example 4. Employer D operates four lines of business as determined under §1.414(r)–2. One of its lines of business is a machine tool shop. Sixty of Employer D's employees provide at least 25 percent of their services to the machine tool shop line of business. Of the six employees who constitute the top 10 percent by compensation of those 60 employees, four are substantial-service employees with respect to the line of business. Because four is 67 percent of six, 80 percent of the top-paid employees with respect to the machine tool shop line of business are not substantial-service employees with respect to that line of business. Therefore the machine tool shop line of business does not satisfy the separate management requirement of paragraph (b)(5) of this section.

Example 5. The facts are the same as in *Example 4*, except that, in addition, another of Employer D's lines of business is an automotive repair shop, and 80 of Employer D's employees provide at least 25 percent of their services to that line of business. Employer D combines the machine shop line of business with the automotive repair shop line of business and treats them as a single line of business. As a result, Employer D has three lines of business as determined under §1.414(r)–2. Assume that 150 of Employer D's employees provide more than 25 percent of their services to the machine tool shop/automotive repair shop line of business within the meaning of paragraph (c)(5) of this section. Of the 15 employees who constitute the top 10 percent by compensation of these 150 employees, 12 are substantial-service employees with respect to that line of business. Because 12 is 80 percent of 15, at least 80 percent of the top-paid employees with respect to the machine tool shop/automotive repair shop line of business are substantial-service employees with respect to that line of business. Therefore, the machine tool shop/automotive repair shop line of business satisfies the separate management requirement of paragraph (b)(5) of this section.

(d) *Optional rule for vertically integrated lines of business*—(1) *In general.* If two lines of business satisfy the requirements of this paragraph (d) with respect to a type of property or service for a testing year, the employer is permitted to apply the optional rule in this paragraph (d) for the testing year.

(2) *Requirements.* Two lines of business satisfy the requirements of this paragraph (d) with respect to a type of property or service only if—

(i) One of the lines of business (the upstream line of business) provides a type of property or service to the other line of business (the downstream line of business);

(ii) The downstream line of business either—

(A) Uses, consumes, or substantially modifies the property or service in the course of itself providing property or services to customers of the employer; or

(B) Provides the same property or service to customers of the employer at a different level in the chain of commercial distribution from the upstream line of business (e.g., retail versus wholesale); and

(iii) The upstream line of business either—

(A) Provides the same type of property or service to customers of the employer, and at least 25 percent of the total number of units of the same type of property or service provided by the upstream line of business to all persons (including customers of the employer, the downstream line of business, and all other lines of business of the employer) are provided to customers of the employer by the upstream line of business, when measured on a uniform basis; or

(B) Provides to the downstream line of business property consisting primarily of a type of tangible property (i.e., goods, not services) that it produces or manufactures, and some entities outside the employer's controlled group that are engaged in a similar business as the upstream line of business provide the same type of tangible property to unrelated customers (i.e., customers outside those entities' respective controlled groups).

(3) *Optional rule—(*i*) Treatment of employees.* For purposes of determining the lines of business to which an employee provides services under paragraph (c)(5) of this section, an employee is not treated as providing services to the downstream line of business if—

(A) The employee is considered to provide services to the downstream line of business under paragraph (c)(5) of this section (applied without regard

to the optional rule in this paragraph (d)); and

(B) The employee is so considered solely because the employee's services contribute to providing the property or service from the upstream line of business to the downstream line of business.

(ii) *Purposes for which optional rule applies.* If an employee applies the optional rule in this paragraph (d), the treatment specified in paragraphs (d)(3)(i) (A) and (B) of this section applies for all the following purposes and only for the following purposes—

(A) The separate employee workforce and separate management requirements of paragraphs (b)(4) and (b)(5) of this section;

(B) The 50-employee requirement of §1.414(r)–4(b); and

(C) The determination of the employees of a qualified separate line of business under §1.414(r)–7.

(4) *Examples.* The following examples illustrate the application of the optional rule in this paragraph (d).

Example 1. Employer E operates two lines of business as determined under §1.414(r)–2, one engaged in upholstery textile manufacturing and the other in furniture manufacturing. During the testing year, the upholstery textile line of business provides its entire output of upholstery textiles to the furniture line of business. The furniture line of business uses the upholstery textiles in the manufacture of upholstered furniture for sale to customers of Employer E. The furniture line of business thus substantially modifies the upholstery textiles provided to it by the upholstery textile line of business in providing upholstered furniture products to customers of Employer E. In addition, although the upholstery textile line of business does not provide upholstery textiles to customers of Employer E, some entities engaged in upholstery textile manufacturing provide upholstery textiles to customers outside their controlled groups. Under these facts, Employer E's two lines of business satisfy the requirements of this paragraph (d) with respect to upholstery textiles for the testing year.

Example 2. Employer B is a multinational controlled group of corporations that engages in the exploration, production, refining, and marketing of petrochemical products. See *Example 10* under paragraph (c)(7) of this section. Employer B operates two lines of business as determined under §1.414(r)–(2). The first line of business (''the exploration, production, and refining line of business'') provides lubricating oil, gasoline, and other petrochemical products to wholesale customers of Employee B as well as the second line of business. The wholesale customers of Employee B include independent jobbers, independent franchisees that operate retail filling stations under Employee B's trademark and tradename, as well as chemical and plastics manufacturers. The second line of business (the ''retail marketing line of business'') provides lubricating oil and gasoline products to retail customers of Employee B through filing stations owned and operated by Employee B. During the testing year, the exploration, production and refining line of business provides 25,000 gallons of lubricating oil, 100,000 gallons of unleaded and 150,000 gallons of leaded gasoline to the retail marketing line of business, and 75,000 gallons of lubricating oil, 500,000 gallons of unleaded gasoline and 15,000 gallons of leaded gasoline to wholesale customers of Employer B. Thus, the exploration, production, and refining line of business provides 75 percent of its output of lubricating oil during the testing year to wholesale customers of Employer B. In addition, because unleaded and leaded gasoline is the same type of property (i.e., gasoline), the exploration, production, and refining line of business provides 67 percent of its output of gasoline products during the testing year to wholesale customers of Employer B. Furthermore, the retail line of business provides lubricating oil and gasoline products to customers of Employer B at different levels in the chain of commercial distribution than the exploration, production, and refining line of business. Under these facts, Employer B's two lines of business satisfy the requirements of this paragraph (d) with respect to both lubricating oil and gasoline products for the testing year.

Example 3. The facts are the same as in *Example 2.* Employer B operates a refinery that produces lubricating oil, gasoline, and other petrochemical products. Employee V is an operating engineer at the refinery who is involved at a stage in the refining process before lubricating oil and gasoline products have been separated from other types of petrochemical products. Employee V performs no other services for Employer B. Absent application of the optional rule in this paragraph (d), Employee V would be considered to provide services to both of Employer B's lines of business. See *Example 11* under paragraph (c)(7) of this section. However, because Employee V's services to the retail marketing line of business contribute solely to providing lubricating oil and gasoline products from the exploration, production, and refining line of business to the retail marketing line of business, under the optional rule in paragraph (d)(3)(i) of this section Employee V is not treated as providing services to the retail marketing line of business.

Example 4. The facts are the same as in *Example 3.* Employee W is a petroleum engineer

who conducts geological studies of potential future drilling sites. Employee W performs no other services for Employer B. Absent application of the optional rule in this paragraph (d), Employee W would be considered to provide services to both of Employer B's lines of business. See *Example 12* under paragraph (c)(7) of this Section. However, because Employee W's services to the retail marketing line of business contribute solely to providing lubricating oil and gasoline products from the exploration, production, and refining line of business to the retail marketing line of business, under the optional rule in paragraph (d)(3)(i) of this section Employee W is not treated as providing services to the retail marketing line of business.

Example 5. The facts are the same as in *Example 4.* Employee Y is a vice president in Employer B's home office. As part of his senior management responsibilities, Employee Y helps to set the rate of production at Employer B's refineries in the United States and also helps to set the price charged at the pump at the retail filling stations owned and operated by Employer B in this country. Absent application of the optional rule in this paragraph (d), Employee X would be considered to provide services to both of Employer B's lines of business within the meaning of paragraph (c)(5) of this section for purposes of satisfying the separate workforce requirement of paragraph (b)(4) of this section. Because Employee X helps to set the price charged at the pump by Employer B's retail marketing line of business, Employee X's services to the retail marketing line of business are not limited to contributing solely to providing lubricating oil and gasoline products from the exploration, production, and refining line of business to the retail marketing line of business, as required under paragraph (d)(3)(i)(B) of this section. Accordingly, even though Employer B's two lines of business satisfy the requirements of this paragraph (d) with respect to both lubricating oil and gasoline products for the testing year, and even though Employer B applies the optional rule in this paragraph (d), Employee X is still considered to provide services to both of Employer B's lines of business.

[T.D. 8376, 56 FR 63442, Dec. 4, 1991, as amended by T.D. 8548, 59 FR 32917, June 27, 1994]

§ 1.414(r)–4 Qualified separate line of business—fifty-employee and notice requirements.

(a) *In general.* This section sets forth the rules for determining whether a separate line of business (as determined under §1.414(r)–3) satisfies the 50-employee and notice requirements of §1.414(r–1(b)(2)(iv) (B) and (C), respectively.

(b) *Fifty-employee requirement.* A separate line of business satisfies the 50-employee requirement of §1.414(r)–1(b)(2)(iv)(B) for a testing year only if on each day of the testing year there are at least 50 employees who provide services to the separate line of business for the testing year and do not provide services to any other separate line of business of the employer for the testing year within the meaning of §1.414(r)–3(c)(5). For this purpose, all employees of the employer are taken into account (including collectively bargained employees), except employees described in §1.414(q)–1, Q&A–9(g)(i.e., the same employees, subject to certain modifications, who are excluded in determining the number of employees in the top-paid group under section 414(q)(4)).

(c) *Notice requirement*—(1) *General rule.* A separate line of business satisfies the notice requirement of §1.414(r)–1(b)(2)(iv)(C) for a testing year only if the employer notifies the Secretary that it treats itself as operating qualified separate lines of business for the testing year in accordance with §1.414(r)–1(b). The employer's notice for the testing year must specify each of the qualified separate lines of business operated by the employer and the section or sections of the Code to be applied on a qualified-separate-line-of-business basis. See §1.414(r)–1(c). The employer's notice must take the form, must be filed at the time and the place, and must contain any additional information prescribed by the Commissioner in revenue procedures, notices, or other guidance of general applicability. No other notice, whether actual or constructive, satisfies the requirement of this paragraph (c).

(2) *Effect of notice.* Once an employer has provided the notice prescribed in this paragraph (c) for a testing year, and the time for filing the notice for the testing year has expired without its being modified, withdrawn, or revoked, the employer is deemed to have irrevocably elected to apply the requirements of the section or sections of the Code specified in the notice separately with respect to the employees of each qualified separate line of business

specified in the notice for all plan years that begin in the testing year. The Commissioner may, in revenue procedures, notices, or other guidance of general applicability, provide for exceptions to the rule in this paragraph (c)(2) as well as for the effect that will be given to the employer's notice for purposes of any future testing year.

[T.D. 8376, 56 FR 63446, Dec. 4, 1991, as amended by T.D. 8548, 59 FR 32919, June 27, 1994]

§ 1.414(r)–5 Qualified separate line of business—administrative scrutiny requirement—safe harbors.

(a) *In general.* A separate line of business (as determined under §1.414(r)–3 satisfies the administrative scrutiny requirement of §1.414(r)–1(b)(2)(iv)(D) for a testing year if the separate line of business satisfies any of the safe harbors in paragraphs (b) through (g) of this section for the testing year. The safe harbor in paragraph (b) of this section implements the statutory safe harbor of section 414(r)(3). The safe harbors in paragraphs (c) through (g) of this section constitute the guidelines provided for under section 414(r)(2)(C). A separate line of business that does not satisfy any of the safe harbors in this section nonetheless satisfies the requirement of administrative scrutiny if the employer requests and receives an individual determination from the Commissioner under §1.414(r)–6 that the separate line of business satisfies the requirement of administrative scrutiny.

(b) *Statutory safe harbor*—(1) *General rule.* A separate line of business satisfies the safe harbor in this paragraph (b) for the testing year only if the highly compensated employee percentage ratio of the separate line of business is—

(i) At least 50 percent; and

(ii) Non more than 200 percent.

(2) *Highly compensated employee percentage ratio.* For purposes of this paragraph (b), the highly compensated employee percentage ratio of a separate line of business is the fraction (expressed as a percentage), the numerator of which is the percentage of the employees of the separate line of business who are highly compensated employees, and the denominator of which is the percentage of all employees of the employer who are highly compensated employees.

(3) *Employees taken into account.* For purposes of this paragraph (b), the employees taken into account are the same employees who are taken into account for purposes of applying section 410(b) with respect to the first testing day. For this purpose, employees described in section 410 (b)(3) and (b)(4) are excluded. However, section 410(b)(4) is applied with reference to the lowest minimum age requirement applicable under any plan of the employer, and with reference to the lowest service requirement applicable under any plan of the employer, as if all the plans were a single plan under §1.410(b)–6(b)(2). The employees of the separate line of business are determined by applying §1.414(r)–7 to the employees taken into account under this paragraph (b)(3). An employee is treated as a highly compensated employee for purposes of this paragraph (b) if the employee is treated as a highly compensated employee for purposes of applying section 410(b) with respect to the first testing day. For the definition of ''first testing day,'' see §1.414(r)–11(b)(7).

(4) *Ten-percent exception.* A separate line of business is deemed to satisfy paragraph (b)(1)(i) of this section for the testing year if at least 10 percent of all highly compensated employees of the employer provide services to the separate line of business during the testing year and do not provide services to any other separate line of business of the employer during the testing year within the meaning of §1.414(r)–3(c)(5).

(5) *Determination based on preceding testing year.* A separate line of business that satisfied this safe harbor for the immediately preceding testing year (without taking into account the special rule in this paragraph (b)(5)) is deemed to satisfy the safe harbor for the current testing year. The preceding sentence applies to a separate line of business only if the employer designated the same line of business in the immediately preceding testing year as in the current testing year and either—

(i) The highly compensated employee percentage ratio of the separate line of business for the current testing year

does not deviate by more than 10 percent (not 10 percentage points) from the highly compensated employee percentage ratio of the separate line of business for the immediately preceding testing year; or

(ii) No more than five percent of the employees of the separate line of business for the current testing year were employees of a different separate line of business for the immediately preceding testing year, and no more than five percent of the employees of the separate line of business for the immediately preceding testing year are employees of a different separate line of business for the current testing year.

(6) *Examples.* The following examples illustrate the application of the safe harbor in this paragraph (b).

Example 1. (i) Employer A operates three separate lines of business as determined under §1.414(r)–3, that respectively consist of a railroad, an insurance company, and a newspaper. Employer A employs a total of 400 employees, 100 of whom are highly compensated employees. Thus, the percentage of all employees of Employer A who are highly compensated employees in 25 percent. After applying §1.414(r)–7, the distribution of highly and nonhighly compensated employees among Employer A's separate lines of business is as follows:

	Employer-wide	Railroad	Insurance company	Newspaper
Number of Employees	400	100	150	150
Number of HCEs	100	20	50	30
Number of Non-HCEs	300	80	100	120
HCE Percentage	25%	20%	33%	20%
	(100/400)	(20/100)	(50/150)	(30/150)
HCE Percentage Ratio	N/A	80%	133%	80%
	.....	(20%/25%)	(33%/25%)	(20%/25%)

(ii) Because the highly compensated employee percentage ratio of each separate line of business is at least 50 percent and no more than 200 percent, each of Employer A's separate lines of business satisfies the requirements of the safe harbor in this paragraph (b).

Example 2. (i) Employer B operates three separate lines of business as determined under §1.414(r)–3, that respectively consist of a dairy products manufacturer, a candy manufacturer, and a chain of housewares stores. Employer B employs a total of 1,000 employees, 100 of whom are highly compensated employees. Thus, the percentage of all employees of Employer B who are highly compensated employees is 10 percent. After applying §1.414(r)–7, the distribution of highly and nonhighly compensated employees among Employer B's separate lines of business is as follows:

	Employer-wide	Dairy products	Candy	Housewares stores
Number of Employees	1,000	200	500	300
Number of HCEs	100	5	50	45
Number of Non-HCEs	900	195	450	255
HCE Percentage	10%	2.5%	10%	15%
	(100/1,000)	(5/200)	(50/500)	(45/300)
HCE Percentage Ratio	N/A	25%	100%	150%
	.....	(2.5%/10%)	(10%/10%)	(15%/10%)

(ii) Because the highly compensated employee percentage ratio for the dairy products line of business is less than 50 percent, it does not satisfy the requirements of the statutory safe harbor in this paragraph (b). However, because Employer B's other two separate lines of business (candy manufacturing and housewares stores) each has a highly compensated employee percentage ratio that is no less than 50 percent and no greater than 200 percent, they each satisfy the statutory safe harbor in this paragraph (b).

Example 3. (i) The facts are the same as in *Example 2*, except that Employer B operates only two separate lines of business as determined under §1.414(r)–3, one consisting of the dairy products manufacturer and the candy manufacturer, and the other consisting of the chain of housewares stores. After applying §1.414(r)–7, the distribution of highly and nonhighly compensated employees among

Employer B's separate lines of business is as follows:

	Employer-Wide	Candy/Dairy Products	Housewares Stores
Number of Employees	1,000	700	300
Number of HCEs	100	55	45
Number of Non-HCEs	900	645	255
HCE Percentage	10%	7.9%	15%
	(100/1,000)	(55/700)	(45/300)
HCE Percentage Ratio	N/A	79%	150%
	.....	(7.9%/10%)	(15%/10%)

(ii) Because the highly compensated employee percentage ratio for both of Employer B's separate lines of business is at least 50 percent and no more than 200 percent, they each satisfy the requirements of the statutory safe harbor in this paragraph (b).

(c) *Safe harbor for separate lines of business in different industries*—(1) *In general.* A separate line of business satisfies the safe harbor in this paragraph (c) for the testing year if it is in a different industry or industries from every other separate line of business of the employer. For this purpose, a separate line of business is in a different industry or industries from every other separate line of business of the employer only if—

(i) The property or services provided to customers of the employer by the separate line of business (as designated by the employer for the testing year under §1.414(r)–2) fall exclusively within one or more industry categories established by the Commissioner for purposes of this paragraph (c); and

(ii) None of the property or services provided to customers of the employer by any of the employer's other separate lines of business (as designated by the employer for the testing year under §1.414(r)–2) falls within the same industry category or categories.

(2) *Optional rule for foreign operations.* For purposes of satisfying this paragraph (c), an employer is permitted to disregard any property or services provided to customers of the employer during the testing year by a foreign corporation or foreign partnership (as defined in section 7701(a)(5)), to the extent that income from the provision of the property or services is not effectively connected with the conduct of the trade or business within the United States within the meaning of section 864(c). Thus, for example, an employer is permitted to take into account only property and services provided to customers of the employer by its domestic subsidiaries and property and services provided by its foreign subsidiaries that generate income effectively connected with the conduct of a trade or business within the United States in determining whether the property or services provided to customers of the employer by a separate line of business fall exclusively within one or more industry categories and also whether the property or services provided by any other separate line of business fall within the same industry category or categories.

(3) *Establishment of industry categories.* The Commissioner shall, by revenue procedure or other guidance of general applicability, establish industry categories for purposes of this paragraph (c).

(4) *Examples.* The following examples illustrate the application of the safe harbor in this paragraph (c). For purposes of these examples, it is assumed that, pursuant to paragraph (c)(3) of this section, the Commissioner has established the following industry categories (among others): transportation equipment and services; banking, insurance, and finance; machinery and electronics; and entertainment, sports, and hotels.

Example 1. Among its other business activities, Employer C operates a commercial airline that constitutes a separate line of business under §1.414(r)–3. In addition, no other separate line of business of Employer C provides to customers of Employer C any property or services in the transportation equipment and services industry category. Under these facts, the separate line of business described in this example satisfies the safe harbor in this paragraph (c).

Example 2. The facts are the same as in *Example 1,* except that Employer C also operates a trucking company that constitutes another separate line of business of Employer C under §1.414(r)–3. Because the commercial airline and the trucking company both provide to customers of Employer C services in the transportation equipment and services industry category, neither separate line of business satisfies the safe harbor in this paragraph (c).

Example 3. Among its other business activities, Employer D operates a commercial bank and luxury hotel that together constitute a single separate line of business under §1.414(r)–3. No other separate line of business of employer D provides to customers of Employer D property or services in either the banking, insurance, or financial industry category, or the entertainment, sports, or hotel industry category. Under these facts, the separate line of business described in this example satisfies the safe harbor in this paragraph (c).

Example 4. The facts are the same as in *Example 3,* except that Employer D also manufactures computers in the United States and abroad. Employer D apportions its computer operations by designating these operations between two separate lines of business, one consisting of its domestic operations located in the United States and the second consisting of its foreign operations by a foreign subsidiary. Because both lines of business provide property and services in the machinery and electronics industry category to customers of Employer D, neither separate line of business would satisfy the safe harbor in this paragraph (c). However, pursuant to the optional rule in paragraph (c)(2) of his section, Employer D disregards the property and services provided by its foreign computer subsidiary. As a result, no other separate line of business of Employer D provides to customers of Employer D any property or services in the machinery and electronics industry category. Under these facts, Employer D's domestic computer operations separate line of business satisfies the safe harbor in this paragraph (c).

(d) *Safe harbor for separate lines of business that are acquired through certain mergers and acquisitions*—(1) *General rule.* A portion of the employer that is acquired through a transaction described in section 410(b)(6)(C) and §1.410(b)–2(f) (i.e., an asset or stock acquisition, merger, or other similar transaction involving a change in the employer of the employees of a trade or business) (the ''acquired line of business'') satisfies the safe harbor in this paragraph (d) for each testing year in the transition period provided in paragraph (d)(3) of this section if each of the following requirements is satisfied—

(i) For each testing year within the transition period the employer designates the acquired line of business as a line of business within the meaning of §1.414(r)–2;

(ii) On the first testing day in each testing year in the transition period:

(A) The acquired line of business constitutes a separate line of business within the meaning of §1.414(r)–3 (taking into account §1.414(r)–1(d)(4));

(B) No more than 10 percent of the employees who are substantial-service employees with respect to the acquired line of business were substantial-service employees with respect to a different separate line of business for the immediately preceding testing year; and

(C) No more than 10 percent of the employees who were substantial-service employees with respect to the acquired line of business for the immediately preceding testing year are substantial-service employees with respect to a different separate line of business in the respective testing year.

(iii) If the transaction described in paragraph (d)(1) of this section occurs after the first testing day in a testing year, the determinations required by paragraphs (d)(1)(ii) (B) and (C) of this section with respect to that testing year are made as of the date of the transaction.

(2) *Employees taken into account.* For purposes of this paragraph (d), the employees taken into account are the same employees who are taken into account for purposes of applying section 410(b) with respect to the first testing day. For this purpose, employees described in section 410(b)(3) and (b)(4) are excluded. However, section 410(b)(4) is applied with reference to the lowest minimum age requirement, and with reference to the lowest service requirement applicable under any plan of the employer that benefits employees of the separate line of business, as if all the plans were a single plan under §1.410(b)–6(b)(2). The employees of the separate line of business are determined by applying §1.414(r)–7 to the employees taken into account under this paragraph (d)(2).

(3) *Transition period.* The transition period for purposes of this safe harbor is the period that begins with the first testing year beginning after the date that the transaction described in paragraph (d)(1) of this section occurs. The employer is permitted, but not required, to extend the transition period to include one, two, or three of the testing years immediately succeeding that first testing year.

(4) *Examples.* The following examples illustrate the application of the safe harbor in this paragraph (d).

Example 1. Employer E is treated as operating three qualified separate lines of business pursuant to §1.414(r)–1(b). In 1996, Employer E acquires a company that employs 4,000 employees who manufacture and sell pharmaceutical supplies, and designates that portion as a line of business under §1.414(r)–2. Under §1.414(r)–1(d)(4), the pharmaceutical supplies line of business is deemed to satisfy the requirements to be a qualified separate line of business (other than the 50-employee and notice requirements) for testing year 1996. In addition, the determination of whether Employer E's remaining three lines of business constitute qualified separate lines of business for testing year 1996 is made without taking into account the acquired employees and by disregarding the property and services provided to customers of Employer E by the pharmaceutical supplies line of business.

Example 2. The facts are the same as in *Example 1* except that, by the first testing day in 1997 (Transition Year 1), there are 300 additional substantial-service employees with respect to the pharmaceutical supplies line of business, increasing the total number to 4,300. Of those 300 employees, 250 were substantial-service employees with respect to a different separate line of business for testing year 1996 and 50 are new hires. Assume that, on the first testing day in Transition Year 1, the pharmaceutical supplies line of business satisfies the requirements of §1.414(r)–3 (taking into account §1.414(r)–1(d)(4)) and therefore constitutes a separate line of business. Because 250 is 6 percent of 4,300, no more than ten percent of the employees who are substantial-service employees with respect to the pharmaceutical supplies line of business were substantial- service employees with respect to a different separate line of business for the immediately preceding testing year. The 50 newly hired employees are disregarded in making this determination. Under these facts, the pharmaceutical supplies separate line of business satisfies the safe harbor in this paragraph (d) for Transition Year 1.

Example 3. The facts are the same as in *Example 2*, except that, before the first day of the next testing year (''Transition Year 2''), Employer E permanently transfers 200 of the 4,300 employees who were substantial-service employees with respect to the pharmaceutical line of business on the first testing day in Transition Year 1 to a different line of business and does not hire any additional employees for the pharmaceutical supplies line of business. Therefore, by the first testing day in Transition Year 2, the number of employees who are substantial-service employees with respect to the pharmaceutical line of business of Employer E has decreased from 4,300 to 4,100. Assume that, on that first testing day in Transition Year 2, the pharmaceutical supplies line of business constitutes a separate line of business within the meaning of §1.414(r)–3. Because 200 is approximately 5 percent of 4,300, no more than 10 percent of the employees who were substantial-service employees of the pharmaceutical line of business for Transition Year 1 are not substantial-service employees of the pharmaceutical line of business in Transition Year 2. Under these facts, the pharmaceutical supplies separate line of business continues to satisfy the safe harbor in this paragraph (d) for Transition Year 2.

(e) *Safe harbor for separate lines of business reported as industry segments*—(1) *In general.* A separate line of business satisfies the safe harbor in this paragraph (e) for the testing year if, for the employer's fiscal year ending latest in the testing year, the separate line of business is reported as one or more industry segments on its annual report required to be filed in conformity with either—

(i) Form 10–K, annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 (''Form 10–K''); or

(ii) Form 20–F, Annual Report Pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934 with Item 18 financials (''Form 20–F''), and the employer timely files either the Form 10–K or Form 20–F with the Securities and Exchange Commission (''SEC'').

(2) *Reported as an industry segment in conformity with Form 10–K or Form 20–F.* For purposes of this paragraph (e), a separate line of business is reported as one or more industry segments in conformity with either Form 10–K or Form 20–F only if—

(i) The separate line of business consists of one or more industry segments within the meaning of paragraphs 10(a),

11(b), and 12 through 14 of the Statement of Financial Accounting Standards No. 14, Financial Reporting for Segments of a Business Enterprise (''FAS 14''); and

(ii) The property or services provided to customers of the employer by the separate line of business (as designated by the employer for the testing year under §1.414(r)–2) is identical to the property or services provided to customers of the employer by the industry segment or segments (as determined under paragraphs 10(a), 11(b), and 12 through 14 of FAS 14).

(3) *Timely filing of Form 10–K or Form 20–F.* For purposes of this paragraph (e), a Form 10–K of Form 20–F is timely filed with the SEC if it is filed within the required period as provided under 17 CFR 240.12b–25(b)(2)(ii). Therefore, the required period for timely filing of the Form 10–K is the 90-day period after the end of the fiscal year covered by the annual report (including the 15-day extension), and the required period for timely filing of the Form 20–F is the 6-month period after the end of the fiscal year covered by the annual report (including the 15-day extension).

(4) *Examples.* The following examples illustrate the application of the safe harbor in this paragraph (e).

Example 1. Among its other business activities, Employer F operates a bearing manufacturing firm that constitutes a separate line of business under §1.414(r)–3. Employer F is required to file an annual Form 10–K with the SEC. On its timely filed Form 10–K, Employer F reports its bearing manufacturing operations as an industry segment in accordance of FAS 14 (as determined under paragraphs 10(a), 11(b), and 12 through 14 of FAS 14). The group of bearing products provided by the separate line of business (as designated by Employer F under §1.414(r)–2) is identical to the group of bearing products provided by the industry segment (as determined under paragraphs 10(a), 11(b), and 12 through 14 of FAS 14). Under these facts, the separate line of business described in this example satisfies the safe harbor in this paragraph (e).

Example 2. The facts are the same as in *Example 1*, except that Employer F has apportioned its bearing manufacturing operations between two separate lines of business as determined under §1.414(r)–3, one engaged in the manufacture of bearings for use in the automotive industry, and a second engaged in the manufacture of bearings for use in the aerospace industry. Because neither separate line of business provides a group of property or services to customers of Employer F that is identical to the group of bearing products provided by the industry segment reported on Employer F's annual Form 10–K, neither separate line of business described in this example satisfies the safe harbor in this paragraph (e).

(f) *Safe harbor for separate lines of business that provide the same average benefits as other separate lines of business*—(1) *General rule.* A separate line of business satisfies the safe harbor in this paragraph (f) for the testing year only if the level of benefits provided to employees of the separate line of business satisfies paragraph (f)(2) or (f)(3) of this section, whichever is applicable.

(2) *Separate lines of business with a disproportionate number of nonhighly compensated employees*—(i) *Applicability of safe harbor.* This paragraph (f)(2) applies to a separate line of business that for the testing year has a highly compensated employee percentage ratio of less than 50 percent (as determined under paragraph (b)(2) of this section).

(ii) *Requirement.* A separate line of business satisfies this paragraph (f)(2) only if the actual benefit percentage of the group of nonhighly compensated employees of the separate line of business for the testing period that ends with or within the testing year is at least as great as the actual benefit percentage of the group of all other nonhighly compensated employees of the employer for the same testing period. See §1.410 (b)–5(c) and (d)(3)(ii) for the definitions of actual benefit percentage and testing period, respectively. In determining actual benefit percentages for purposes of this paragraph (f)(2)(ii), the special rule in §1.410(b)–5(e)(3) (permitting an employer to determine employee benefit percentages separately for defined contribution and defined benefit plans) may not be used.

(3) *Separate lines of business with a disproportionate number of highly compensated employees*—(i) *Applicability of safe harbor.* This paragraph (f)(3) applies to a separate line of business that for the testing year has a highly compensated employee percentage ratio of more than 200 percent (as determined under paragraph (b)(2) of this section).

(ii) *Requirement.* A separate line of business satisfies this paragraph (f)(3)

only if the actual benefit percentage of the group of highly compensated employees of the separate line of business for the testing period that ends with or within the testing year is no greater than the actual benefit percentage of the group of all other highly compensated employees of the employer for the same testing period. See §1.410 (b)–5(c) and (d)(3)(ii) for the definitions of actual benefit percentage and testing period, respectively. In determining actual benefit percentages for purposes of this paragraph (f)(3)(ii), the special rule in §1.410(b)–5(e)(3) (permitting an employer to determine employee benefit percentages separately for defined contribution and defined benefit plans) may not be used.

(4) *Employees taken into account.* An employee of a separate line of business (as determined under §1.414(r)–7 is taken into account for a testing period for purposes of this paragraph (f) only if the employee is an employee of the separate line of business on the first testing day, and would not be an excludable employee for purposes of applying the average benefit percentage test of §1.410(b)–5 to a plan for a plan year included in that testing period. In determining whether an employee is an excludable employee for purposes of the average benefit percentage test, the employer is assumed not to be operating qualified separate lines of business under §1.414(r)–1(b). An employee is treated as a highly compensated employee for purposes of this paragraph (f) if the employee is treated as a highly compensated employee for purposes of applying section 410(b) on the first testing day. See §1.414(r)–11(b)(7) for the definition of ''first testing day''.

(5) *Example.* The rules of this paragraph (f) are illustrated by the following example.

Example. (i) Employer G is treated as operating two separate lines of business, Line 1 and Line 2, in accordance with §1.414(r)–1(b). Employer G maintains three qualified plans. Plan A is a calendar-year profit-sharing plan that benefits all employees of Employer G. Plan B is a defined benefit plan with a plan year ending March 31 that benefits all employees of Line 1. Plan C is a defined benefit plan with a plan year ending November 30 that benefits all employees of Line 2.

(ii) In 1995, Line 1 has a highly compensated employee percentage ratio of 25 percent. Employer G's first testing day is March 31. After applying the rules of §1.414(r)–7, the nonhighly compensated employees of Line 1 and Line 2 on March 31, 1995, are N1–N80 and N81–N100, respectively. N1 is an excludable employee under §1.410(b)–6 for purposes of the average benefit percentage test during the testing period that includes the plan years of Plans A, B, and C that end in 1995 (the ''1995 testing period''), and would therefore not be taken into account in determining whether any of those plans satisfied the average benefit percentage test of §1.410(b)–5 for plan years included in that testing period, because N1 does not satisfy the minimum age and service conditions under any plan of the employer. All other employees of Line 1 and Line 2 on March 31, 1995 are nonexcludable employees for purposes of the average benefit percentage test during the 1995 testing period.

(iii) In order for Line 1 to satisfy the requirements of this paragraph (f) for 1995, the actual benefit percentage of N2–N80 for the 1995 testing period under Plans A, B and C must be at least as great as the actual benefit percentage of N81–N100 for the same testing period under the same plans. N1 is not taken into account because N1 is an excludable employees for purposes of the average benefit percentage test for the 1995 testing period. Any other employees who were taken into account for purposes of the average benefit percentage test for the 1995 testing period are excluded because they are not employees of Line 1 or Line 2 on March 31, 1995.

(g) *Safe harbor for separate lines of business that provide minimum or maximum benefits.* —(1) *In general.* A separate line of business satisfied the safe harbor in this paragraph (g) for the testing only if the level of benefits provided to employees of the separate line of business satisfies paragraph (g)(2) or (g)(3) of this section, whichever is applicable. For this purpose, the level of benefits is determined with respect to all qualified plans of the employer that benefit employees of the separate line of business for plan years that begin in the testing year.

(2) *Minimum benefit required*—(i) *Applicability.* This paragraph (g)(2) applies to a separate line of business that for the test year has a highly compensated employee percentage ratio of less than 50 percent (as determined under paragraph (b)(2) of this section).

(ii) *Requirement.* A separate line of business satisfies this paragraph (g)(2) only if one of the following requirements is satisfied—